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SUBJECT: WHILE WILMA RAGES, PLANS DRAWN UP FOR NEW ALBERTA GULF COAST OIL PIPELINE

SUMMARY

1. Some may question Altex President Jack Crawford's timing. His October 14th press release that his newly-formed Calgary company is proposing a heavy crude oil pipeline line from northern Alberta to the refineries of southeast Texas may have raised a few eyebrows, as meteorologists warned that the largest Atlantic hurricane in history would soon be hitting the Gulf Coast. However, few can doubt Crawford's good business sense: the proposed pipeline would undercut competitors' costs by a third, and come on-stream just as oil producers in Alberta are seeking to diversify their markets. While Altex faces many challenges, both regulatory and financial, in completing the project, current energy market realities could make its construction a question of when, not if. The pipeline, which is expected to carry 250,000 bpd initially from Alberta's tarsands, could under an "optimistic" scenario, be operational by 2010. Calgary CG, Econ Assistant and fall intern visited Altex Energy October 19th to discuss the new pipeline proposal. End summary.

THE NEW LOGIC

2. Altex Energy was founded earlier this year by former employees of the Alliance Pipeline, which delivers natural gas from Fort St. John, British Columbia to Chicago and markets beyond. This C\$5.8 billion pipeline, which was an idea scribbled on a table napkin in 1995, began delivering natural gas to the U.S. Midwest in 2000. By utilizing the experience and success of the Alliance pipeline, members of the Altex management team hope to convince the oil industry and government regulators that their proposal will be the most cost-effective, environmentally friendly partner for Alberta's booming oilsands. While still only in its first stages, the pipeline project has financial backing from several investors, including Calgary-based Kern Energy Partners 1 Fund (KEP), a private equity fund with a focus on Canadian energy sector resource development. KEP has C\$230 million of committed capital from a group of partners that includes North American pension funds.

3. Jack Crawford told us that the unique design of the estimated \$3 billion Altex pipeline will enable it to transport heavy crude at only two-thirds the cost of its competitors. Central to the Altex strategy is to develop a "straight shot" pipeline from Alberta to Texas, approximately 2000 kilometers, similar in scope to the Alliance pipeline. Current pipeline systems generally travel a circuitous route through central Canada to Chicago and Minneapolis before making their way to the southeast. While these designs were once the most economical means available for delivering crude oil to refineries on the Great Lakes, Crawford told us that logic has changed. US oil exports from Canada have increased so much in recent decades that the percentage of refineries devoted to Canadian crude has risen from half to nearly 100%. Crawford estimates Gulf Coast refining capacity at some seven million bpd, with the capacity to refine two million bpd of heavy crude. Also working in Altex's favor is their pipeline's low profit threshold. Crawford told us that the Altex pipeline will only need to ship 250,000 barrels per day (bpd) to stay economical, compared to the average 400,000 bpd needed by other systems to break even. Of course, with most energy experts predicting sustained high energy prices, Altex plans leave room for expansion; the proposed pipeline would have a maximum volume of some 750,000 bpd, just under current total daily Alberta oilsands production of one million bpd.

COMPETITION ALIVE AND WELL

4. Altex is not without competition, as several players in the pipeline industry, with an eye to future oil development, have formulated proposals of their own. Calgary-based Enbridge Inc., Canada's dominant oil pipeline company, has advanced several designs, most notably their proposed C\$4 billion "Gateway" project aimed at transporting 400,000 bpd of crude from northern Alberta to Kitimat, British Columbia and on to markets in Asia. Extensions of its U.S. Midwest system are also planned. In

addition to Terasen Pipelines' proposed C\$210 million expansion of its Trans Mountain oil pipeline from Alberta to British Columbia, Calgary-based TransCanada Corp., Canada's largest transporter of natural gas, hopes to grab a share of the market by moving early, converting one of its primary natural gas pipelines from west to east into an oil pipeline (known as "Keystone") directed towards U.S. markets south of Manitoba. None of the proposals, however, are expected to come to fruition for at least several years.

DRIVING A HARD BARGAIN (10,000 TIMES OVER)

15. Although economic circumstances ensure increasing demand for pipelines such as Crawford's, regulatory challenges could forestall Altex for years to come. Federal governments, environmental boards, First Nations, and local landowners must all be placated before construction begins. While it will take time and energy to acquire regulatory approval from Canada's National Energy Board (NEB), permits in the United States are typically even more difficult to obtain. Crawford noted to us that natural gas pipelines can be approved by the Federal Energy Regulatory Commission (FERC), but oil pipelines operate under a separate regulatory regime, and are subject to purview by every state government through which a pipeline passes. The Altex pipeline would pass through seven: Montana, South Dakota, Nebraska, Kansas, Oklahoma, Texas, and possibly Louisiana. Altex must negotiate terms with each individual property owner its pipeline will run through, meaning multiple tens of thousands of agreements. While Crawford says it is likely that Altex will be given the same expropriation and property condemnation powers that Alliance was awarded in 1998, he expects they will rarely be used noting, "99.5% of the time with Alliance we were able to obtain permission without employing such extreme measures".

17. A final challenge for Altex, assuming the infant company acquires the necessary regulatory and land use approvals, will be competing for scarce labor resources. With Alberta building permits increasing by 30% this year and busy cranes a common sight in Edmonton and Calgary, few construction contractors are eager to take on more work. However, this problem also emphasizes the logic of new pipelines; while some Albertans would prefer value-adding refinery capacity in-province, the labor necessary for such a massive upgrade simply isn't available. Additionally, Crawford told us that Altex would not face these acute labor shortages south of the border, where the unemployment rate is several points higher. All of that said, Crawford told us that, "optimistically", the pipeline could be in operation by 2010 when oilsands production is projected to rise to nearly two million barrels per day.

COMMENT

18. The timing of Altex's pipeline could hardly be more fortuitous. The price spikes brought on by the damage done to Gulf oil production demonstrate the need to diversify U.S. crude oil supplies. Refineries in the southeast continue to upgrade their heavy oil capacity, while the world market for light crude continues to tighten. Republic Senator Orrin Hatch's recent comments underscore the increasing importance of Canada's role in the ongoing diversification process, as Alberta's oilsands producers strive to fill demand to a nation seeking independence from unstable oil exporters.

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